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Financial Markets

Irving Trust

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Economic Research & Planning Division

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Rates moved up this week, reversing the modest rally of the previous week. Market participants were discouraged by the strength reported in various economic indicators as well as by the firmness of the Federal funds rate on Thursday and Friday. As a result, rates generally backed up to their levels of approximately two weeks ago.

It is now clear that the Fed is sticking to its long-run growth path for non-borrowed reserves and thus is forcing banks to borrow through the discount window to cover the increased reserve need caused by the recent rapid rate of deposit growth. Apparently, the Fed waited to see whether the early August surge in the money stock--which raised required reserves in the statement week ended August 20--would wash out in the following week and, in the meantime, accommodated the reserve need. However, when only part of the increase was subsequently reversed, the Fed forced banks to borrow, thus putting pressure on interest rates. The following figures (in millions of dollars) tell the story:

Statement Week Ending	Excess Reserves	Borrowed Reserves	Net Borrowed Reserves
August 13	376	390	41
August 20	393	344	-49
August 27	89	700	611
September 3	654	1348	694

Indications are that borrowing in the statement week ended Wednesday, September 10, was also substantial, though not so high as in the previous week. With the discount rate at 10%, this means that, barring large declines in the money stock, Federal funds should trade in the 10%-plus range for at least the next couple of weeks, as they have since late August.

Looking further ahead, the prospects seem good that growth of the narrower monetary aggregates will slow from the torrid August pace, and this should lead to some easing tendency in short-term and long-term rates. However, one should not exaggerate the magnitude of the likely rally. It seems clear that the economy is in the process of bottoming out and should start to recover in the fourth quarter. Meanwhile, the dollar remains subject to pressure in the foreign exchange markets, and inflation is continuing at an unacceptably rapid pace. In this setting, it is highly improbable that the FOMC, at its meeting on Tuesday, September 16, will vote for any change in its policy stance. Instead, as Chairman Volcker has emphasized so many times, the Fed will remain resolute in its long-haul strategy of slowing the rate of monetary growth and thus the rate of inflation. In the near term, this strategy is likely to slow the pace of the recovery--especially in the housing sector. Nevertheless, to the Fed the price seems worth paying. That should restrict the magnitude of reductions on interest rates in the months to come, while providing benefits later on.

William C. Melton

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Market Yields

	9/12/80	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	(Noon)		
Short-term loans to substantial depositors with highest credit rating	12.25%	11.50%	13.00%
Effective since	9/12/80		
Discount Rate at Federal Reserve Bank	10.00	10.00	10.50
Federal Funds	10.75	10.25	11.38
Repurchase Agreements	10.00	9.50	11.00
U.S. Treasury Issues			
Bills			
3 months	10.60	9.68	10.85
6 months	11.10	9.90	11.00
1 year	11.30	9.86	10.90
Coupons			
2 years	11.42	10.78	10.10
4 years	11.40	11.02	9.40
7 years	11.45	11.16	9.35
10 years	11.35	11.17	9.32
Long Bond	11.20	11.00	9.14
Negotiable Certificates of Deposit-Secondary Market			
1 month	10.75	10.30	11.95
3 months	11.15	10.75	12.10
6 months	11.50	11.25	12.10
1 year	11.75	11.50	12.12
Banker's Acceptances			
1 month	10.70	10.20	11.95
3 months	11.20	10.55	12.10
6 months	11.60	10.75	12.25
Eurodollar Deposits			
1 month	11.00	10.75	12.19
2 months	11.44	11.25	12.63
3 months	11.75	11.50	12.75
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	10.50	9.00	11.50
1 month	10.63	9.88	11.63
3 months	10.50	9.88	10.50
Bank Holding Companies			
1 month	10.50	9.63	11.65
Dealer Placed:			
3 months	10.75	10.13	11.70
New AA Corporate Utility Bond	13.00	12.88	10.05
Tax Exempt			
6 month Project Notes	5.90	5.80	5.55
1 year AAA Bond	6.10	5.60	N/A
5 year AAA Bond	6.30	6.00	N/A
20 year AAA Bond	8.20	8.20	6.10

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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